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Financial Markets

Irving Trust

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Friday (Noon) Nov. 21, 1980

Financial markets this week were thin and highly volatile, with rates uniformly higher than the week before. The main factors behind the gyrating upward thrust were the Federal Reserve's increase of its discount rate last Friday and abundant signs of difficulty on the part of banks and the Fed in coping with the new system of reserve requirements. Meanwhile, no one seemed interested that the FOMC had met on Tuesday, and focused instead on the delay in release of the money stock data.

In many ways the current market setting is reminiscent of that in late March of this year. At that time, the Fed introduced a credit restraint program which caused considerable confusion, as the new reserve requirements and reporting procedures apparently are doing now. Also the Fed, then as now, increased its discount rate, adding a supplementary charge for banks which were frequent borrowers, e.g., those which borrow more than four times in a quarter.

However, there are differences, too. This time the supplementary discount rate was imposed in the middle of the quarter, when many banks had already borrowed several times. Thus, for those banks the extra charge was effective immediately, and undoubtedly made them unusually aggressive in bidding for funds. In addition, the difficulty of calculating the new reserve requirements probably also made some smaller banks less willing to sell their excess reserves. All of this was sufficient to put upward pressure on the funds rate. In addition, the pattern of open market operations in the statement week ended Wednesday suggests strongly that the Fed was slow to perceive the emerging reserves shortage.

The implication: As these temporary distortions are worked out, the funds rate should come down to a more normal relationship relative to the discount rate, perhaps in the 15% area. That would be good news to the securities markets. But the problem is that Treasury bills, for example, are already priced to reflect the market's anticipation of sharply lower financing costs in the near term. Thus, should rapid declines in the funds rate fail to occur, that sector could be quite exposed to a rate correction.

In addition, it is probably highly significant that, when the discount rate was increased last Friday, the Fed already had a large amount of the new data from nonmember banks reporting weekly for the first time, so it was aware of the direction and rough magnitude of the "benchmark" revisions to be applied to the money data. Since the Fed is experiencing severe problems with the new reporting process and will probably continue to do so for a few weeks, the release of the new money data--together with benchmark revisions of the earlier numbers--will be delayed, and the market remains exposed to bad news on that front. On the other hand, it is reasonably likely that the Fed has already incorporated the new data into its policy stance and will not react further when the data are released.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	11/21/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(NOON)		
Short-term loans to substantial depositors			
with highest credit rating	17.00%	15.50%	15.75%
Effective since	11/21/80		
Discount Rate at Federal Reserve Bank	12.00	11.00	12.00
Federal Funds	18.00	14.00	12.38
Repurchase Agreements	16.00	13.50	12.00
U.S. Treasury Issues			
Bills			
3 months	14.89	13.85	11.85
6 months	15.19	14.20	12.40
1 year	14.51	13.75	12.10
Coupons			
2 years	13.74	13.10	11.82
4 years	13.21	12.90	11.05
7 years	12.82	12.75	10.65
10 years	12.75	12.65	10.53
Long Bond	12.35	12.30	10.24
Negotiable Certificates of Deposit-Secondary Market			
1 month	16.10	15.00	13.30
3 months	16.35	15.10	13.55
6 months	16.00	15.00	13.55
1 year	14.25	14.00	13.25
Banker's Acceptances			
1 month	16.00	14.80	13.30
3 months	15.80	15.20	13.60
6 months	15.00	15.00	13.70
Eurodollar Deposits			
1 month	17.00	15.19	13.63
2 months	17.00	15.56	14.63
3 months	17.00	15.63	14.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	14.75	13.00	8.00
1 month	14.75	13.75	13.00
3 months	14.00	13.25	12.63
Bank Holding Companies			
1 month	15.40	14.13	13.13
Dealer Placed:			
3 months	16.13	14.38	13.38
New AA Corporate Utility Bond	14.38	14.50	11.75
Tax Exempt			
6 month Project Notes	8.05	7.60	6.40
1 year AAA Bond	7.00	7.00	NA
5 year AAA Bond	7.00	7.00	NA
20 year AAA Bond	8.90	8.75	7.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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